Unusual Expenses’ Raise Concerns

HEARD ON THE STREET

By Aaron Elstein
The Wall Street Journal Online

Painting a Different Picture

Earlier this month, Waste Management said the $1 million it spent to paint some of its 32,000 waste-removal vehicles was an ‘unusual expense’ - that is, outside of the ordinary costs it incurs doing business. This, along with $30 million in 'unusual' consulting fees, helped the company report pro forma second-quarter earnings one cent higher than analysts' consensus expectations.

Earnings figures for the quarter ended June 30, in millions

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<th>Pro forma earnings</th>
<th>Net earnings</th>
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<td>$212</td>
<td>$191</td>
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Weekly closing share price of Waste Management

Co. and Answerthink, which helped Waste Management develop better information-technology and ‘market strategy’ systems, she says. Christine Yee, a spokeswoman at Andersen, Waste Management’s auditor, says the firm as a matter of policy doesn’t comment on client audits.

Waste Management, which says it operates the country’s sixth-largest truck fleet with 32,000 vehicles, is among scores of companies these days trying to shore up earnings by asking investors to overlook what they describe as unusual or special expenses. Waste Management, however, has special concerns when it comes to accounting.

In February 1998, Waste Management admitted that it had overstated
Waste Management Counts Truck Painting As ‘Unusual’ Expense and Beats Expectations

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earnings from 1992 to 1996 and through the first three quarters of 1997. The Securities and Exchange Commission later determined that Waste Management improperly deferred operating expenses into the future. The accounting scandal led to $2.9 billion in charges and earnings restatements.

Shortly after Waste Management merged with USA Waste, a second accounting scandal emerged, and the newly combined company took a charge of $1.25 billion against third-quarter earnings in 1999. “Both companies were doing things that were wrong,” says former Waste Management director Roderick Hills, also a former SEC chairman. Mr. Hills currently is a consultant to Waste Management.

Waste Management and Andersen paid $220 million in 1999 to settle suits filed by investors who bought Waste Management stock at inflated prices. The accounting problems also led to an investigation by the SEC. In June, Andersen agreed to pay a $7 million fine to the SEC to settle fraud allegations in connection with the accounting firm’s audits of Waste Management’s financial results. Neither Waste Management nor the auditor admitted any wrongdoing. Neither Waste Management nor any of its employees have been disciplined by the SEC, whose investigation is continuing.

Many investors and analysts believe Waste Management has discarded its tarnished past, and the company’s shares have surged this year. The stock yesterday rose $1 to $31 in New York Stock Exchange trading yesterday, less than $1 away from its 52-week high on July 20.

Deutsche Banc Alex. Brown analyst Stacy Devine, who rates Waste Management shares “strong buy,” noted the truck-painting expense in a footnote to a report discussing second-quarter earnings, but didn’t discuss the charge, instead focusing on management’s efforts to turn the company around. “We continue to believe that the company will make significant progress in this turnaround,” she wrote in a recent report.

Other companies operating large truck fleets say they treat truck painting as a normal expense. At Amerco, which is parent of U-Haul, painting the company’s fleet of 107,000 trucks and trailers is “just part of our normal equipment costs,” says spokesman Jennifer Plachman. She says the Rent-A-Center company frequently updates the look of its fleet, which bear the company’s logo and a symbol of one of 24 states. Ditto for Ryder Systems and Allied Waste Industries, which say they don’t consider painting trucks to be an unusual expense.

Mr. Hills, the former Waste Management director, defends the company’s decision to account for truck painting as unusual. He says the company should have included the truck-painting charges as part of the extraordinary expenses incurred when Waste Management and USA Waste merged. But the newly combined company was struggling to cope with so many complex accounting issues at the time, the matter of truck-painting costs didn’t come up until after the merger was completed.

Waste Management started treating accelerated truck painting as an unusual item in the third quarter of 1998. In total this year, it says it expects to take $10 million on unusual charges for truck painting.

Accounting standards allow companies to separate “extraordinary” gains or losses from the rest of their figures in financial statements so investors can better understand how a company’s core business is performing. But for items to qualify as extraordinary, “they must be both ‘unusual in nature’ and ‘non-recurring’ by accounting experts,” says.

Most costs do not qualify for extraordinary treatment, says Howard Schilli, president of the Center for Financial Research and Analysis in Rockville, Md. “What companies are doing is splitting the definition into two parts to justify taking out what they consider ‘usual’ expenses or items that are non-recurring,” Mr. Schilli says.

Tom Ford, an analyst at Lehman Brothers who rates Waste Management shares “strong buy,” says that while investors can debate whether the company should classify the truck-painting and consulting expenses as unusual, he is encouraged that the company took $1 million in such expenses in the second quarter, down from $7 million in the first quarter. “If you think the stock is attractive over the long term, expenses such as this shouldn’t make a difference,” he says.